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IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1955

No. 352

MILWAUKEE & SUBURBAN TRANSPORT CORPORATION,
A Wisconsin public service corporation,
Appellant,

v.

PUBLIC SERVICE COMMISSION OF WISCONSIN,
Appellee,

CITY OF MILWAUKEE AND MILWAUKEE
BOARD OF SCHOOL DIRECTORS,
Intervening Appellees.

Appeal from the Supreme Court of the State of Wisconsin

STATEMENT AS TO JURISDICTION AND APPENDICES

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HAMMERSMITH-KORTMEYER CO., MILWAUKEE

INDEX

	Page
Introductory Statement	1
Opinion Below	2
Jurisdiction	2-4
Question Presented on this Appeal	4-5
Statement of the Case	6-13
Material Facts	6-10
Ratio Decidendi of the Wisconsin Judgment	10-11
The Question presented is Substantial	11-13
Argument	13-32
A. The Commission Order fixes fares on the basis of an arbitrary write-off of plant property concededly having service value, which therefore violates the Fourteenth Amendment	13-18
B. Consumption of capital or service value in depreciable assets, not price for transfer of title to plant assets, measures the cost of service to be covered by the annual depreciation allowance	19-25
The Commission's fallacious justification for its Order	25-28
Subordinate errors in the Wisconsin Supreme Court's justification for the Commission Order	29-33
Conclusion	34

Cases Cited

American Telephone & Telegraph Co. v. United States, 299 U. S. 232	13-15
Atchison, Topeka & Santa Fe R. Co. v. Public Utilities Commission of California, 346 U. S. 346	3-4
Cities Service Gas Co. v. Federal Power Commission, 155 Fed. (2d) 694	29

Page

City of St. Francis v. Public Service Commission of Wisconsin, 270 Wis. 91, 70 N.W. (2d) 221 18

Columbus Gas & Fuel Co. v. Public Utilities Commission of Ohio, et al, 292 U. S. 398, 78 L. Ed. 1327 23-24

Federal Power Commission v. Hope Natural Gas Co., 320 U. S. 591 ..... 19, 26-28, 32

Federal Power Commission, et al v. Natural Gas Pipeline Co., et al, 315 U. S. 575 24-25

Hamilton v. Regents of University of California, 293 U. S. 245 4

Harrisburg Steel Corp. v. Pennsylvania Public Utility Commission and Pennsylvania Power & Light Co., 109 Atl. (2d) 719 ..... 17-18, 29

In theMatter of Cities Service Gas Company, F.P.C. Rep., Vol. 3, p. 459 29-30

Lindheimer, et al v. Illinois Bell Telephone Co., 292 U. S. 151 24

Los Angeles Gas & Electric Corp. v. Railroad Commission of California, et al, 289 U. S. 287, 77 L. Ed. 1180 23

State of Missouri ex rel. Southwestern Bell Telephone Co. v. Public Service Commission, 262 U. S. 276, 67 L. Ed. 981 ..... 22, 31-32

Sultan Railway & Timber Co. v. Department of Labor and Industries of State of Washington, 277 U. S. 135 4

United Railways & Electric Co. v. West, 280 U. S. 234 19

Waukesha Gas & Electric Co. v. Railroad Commission, 181 Wis. 281 31

Williams v. Bruffy, 96 U. S. 176 4

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STATEMENT AS TO JURISDICTION

This is an appeal from a judgment of the Supreme Court of the State of Wisconsin entered on February 8, 1955, confirming in all respects an Order of the Public Service Commission of Wisconsin dated September 17, 1953.

Opinion Below

The Opinion and judgment of the Supreme Court of the State of Wisconsin (appearing on R. pp. 231-243) is reported in 268 Wis. 573, 68 N.W. (2d) 552, and is also set forth in Appendix A hereof. (Herein citations to this Appendix will be indicated as follows: Ap. A, p. .....) The Order of the Public Service Commission of Wisconsin (hereinafter referred to as "the Commission") dated September 17, 1953 (R. pp. 102-117) is reported in 38 P.S.C.W.R. 461. Material portions of this Order are set forth in Appendix B hereof. In Orders dated May 13, 1954 (R. pp. 182-186) and November 5, 1954 (R. pp. 186-198), the Commission in computing net operating revenues from the fares it authorized Appellant to charge, reaffirmed and continued its method of determining the annual depreciation to be allowed Appellant, which determination effects a confiscation of Appellant's property. Said later Orders are not yet officially reported, but material portions thereof are set forth in Appendix C hereof.

Jurisdiction

The judgment appealed from was entered on February 8, 1955. A motion for rehearing, (R. pp. 244-246) duly served and filed, was denied by the Wisconsin Supreme Court on April 5, 1955. (R. p. 248) The notice of appeal to this Court was served on Appellees and, with proof of such service, was filed with the Clerk of the Supreme Court of the State of Wisconsin on June 30, 1955. (R. pp. 1-8)

Orders of the Public Service Commission of Wisconsin fixing fares which Appellant may charge for its public transportation service are rendered pursuant to Sections

194.19 and 195.05(1) of the Wisconsin Statutes, which empower said Commission to fix fares which shall be just and reasonable. Said Wisconsin Statutes are set forth in Appendix D hereof.

The unconstitutional confiscation effected by the Commission Order was challenged in the Motion for Rehearing duly filed with the Commission on September 29, 1953 (R. pp. 209-212), and in the Petition to the Circuit Court for Dane County, Wisconsin for judicial review of said Commission Order (R. pp. 213-219). On the original appeal to and also specifically in the Motion for Rehearing (R. pp. 244-246) by the Wisconsin Supreme Court the Federal constitutional issue was raised.

The jurisdiction of this Court for this review is conferred by Title 28 United States Code in subparagraph (2) of Section 1257.

The following decisions sustain the jurisdiction of this Court to review on direct appeal said judgment of the Wisconsin Supreme Court which confirms said Commission Orders.

Atchison, Topeka & Santa Fe R. Co. v. Public Utilities Commission of California, 346 U.S. 346, wherein it was stated, at pages 348-349:

> "We think the Commission's orders must be treated as an act of the legislature for purposes of determining our jurisdiction under 28 USC § 1257 (2). *Live Oak Water Users' Assn. v. Railroad Commission,* 269 U. S. 354, 356; *Lake Erie & Western R. Co. v. Public Utilities Commission,* 249 U. S. 422, 424. The Commission has construed § 1202 as authorizing these orders. The appellants presented squarely to the Supreme Court of California their contention that in the allocation of costs, these orders take their property without due process of law and are so arbitrary

and burdensome as to constitute an interference with interstate commerce, in violation of the Constitution of the United States. In sustaining the Commission's orders by denying writs of review, the Supreme Court of California upheld the statute as applied by the Commission, and the cases are properly here on appeal. *Kansas City S. R. Co. v. Road Improvement District,* 256 U. S. 658, 659-660."

See also:

Sultan Railway & Timber Co. v. Department of Labor and Industries of State of Washington, 277 U. S. 135.

Hamilton v. Regents of University of California, 293 U. S. 245.

Williams v. Bruffy, 96 U. S. 176, 183.

QUESTION PRESENTED ON THIS APPEAL

On December 30, 1952 Appellant acquired its transportation system for $10,000,000.

The Commission on May 19, 1953 ordered the Appellant to compute its annual depreciation expense by applying to the original cost of depreciable assets as determined by the Commission, depreciation rates specified by the Commission. Appellant was also ordered to carry in an account entitled "Amortization of Plant Acquisition Adjustment", a credit of $4,905,712.37. This credit was the amount by which the depreciated original cost of Appellant's plant assets, determined by the Commission as of December 30, 1952, exceeded the purchase price assigned by the Commission to said plant assets. The Commission directed amortization of this credit over 15 years, i.e., $327,047 annually. (R. pp. 136-141)

In this and subsequent proceedings in which the Commission fixed fares for Appellant's transportation service, the Commission found Appellant entitled to earn annually $768,000-$770,000 after operating expenses, including proper depreciation and taxes. However, the Commission arbitrarily reduced Appellant's operating expenses by *treating as an operating expense* the *negative* annual write-off of said $327,047 credit, and *pro tanto* artificially inflated the forecast of net operating revenues which the authorized fares would produce.

The question presented on this appeal is:

> May the State of Wisconsin, by an order of its Public Service Commission, constitutionally, i.e., with due process of law under the Fourteenth Amendment to the Federal Constitution, so limit fares for public transportation service that as an end result —
>
> (1) the net operating revenues, instead of being $768,000, which the Commission found the Appellant was entitled to earn, will not exceed $441,053 ($768,000 minus $327,047),
>
> (2) the consequent return will be only 2.91% of the depreciated original cost of the property used and useful in rendering said public service, and
>
> (3) although Appellant's plant assets with a depreciated original cost of $13,872,028 as of December 30, 1952 are being consumed in rendering transportation service for the public, by limiting the depreciation so as to permit recoupment only of the purchase price of $8,966,315, Appellant's property to the extent of $4,905,712 is confiscated and taken for public use without compensation in the annual amount of $327,047.

STATEMENT OF THE CASE

There are no factual issues involved in this appeal. The facts material to the question presented on this appeal are established by decisions and formal findings of the Commission, which are part of the record herein. Most of said material facts appear in the opinion of Mr. Justice Currie of the Wisconsin Supreme Court, set forth in Appendix A hereof. For this reason record references will be confined to the facts hereinbelow stated when not recited in said opinion.

Material Facts

Appellant applied to the Commission for a Certificate authorizing it to purchase from The Milwaukee Electric Railway & Transport Company for $10,000,000 the Milwaukee metropolitan local passenger transportation system, which, for over thirty years, had been subject to regulation by the Commission and its predecessors in authority. The Commission issued the requested Certificate of Authority on December 15, 1952, and therein noted the following facts:

The seller was a 100% subsidiary of the Wisconsin Electric Company, a registered holding company under the Federal Public Utility Holding Company Act, and formerly a part of the holding company system comprising the North American Company. In accordance with the Federal statute, proceedings were then pending before the Securities & Exchange Commission involving the divestment by the Electric Company of its investment outside the utility business. Although no direct order in respect to divestment of the transportation properties had been made, the Securities & Exchange Commission had made determinations in respect to other transportation com-

panies in the North American System which made it evident that the Electric Company could not much longer continue to retain its interest in the said transportation system. (R. p. 125) Sale of physical assets was the method selected by the seller for divesting itself of its transportation system primarily because, in addition to the $10,000,000 paid by Appellant, a reduction in Federal income taxes of about $4,500,000 could be realized from a sale of assets instead of stock. (R. pp. 126, 175)

As of June 30, 1952 the properties sold were carried in the plant accounts of the seller (R. p. 127) in the following aggregate amounts:

Property and plant	$29,980,045
Less reserve for depreciation	11,805,286
Net property and plant	$18,174,759

When the Commission issued its Certificate of Authority on December 15, 1952, it retained jurisdiction in respect to the accounting entries to be placed on the books of Appellant relating to the acquisition of said transportation system. (R. p. 135) On May 19, 1953, after the staff of the Commission had investigated the purchase transaction and the original cost and depreciation of the plant assets acquired by Appellant, the Commission, in a Supplemental Accounting Order, found (R. pp. 137-139) that as of December 30, 1952 the plant assets acquired by the Appellant —

(1) had an original cost of $29,926,800.04,

(2) should have a depreciation reserve requirement of $16,054,771.78, instead of the seller's depreciation reserve which was $11,805,286 on June 30, 1952,

(3) had a depreciated original cost of only $13,872,028.26, instead of the seller's $18,174,759 used by the

Commission in prior proceedings for fixing fares for seller.

(4) had been purchased for a price of $8,966,315.89, the remainder of the $10,000,000 purchase price being for the acquired material and supplies, accounts receivable, prepaid taxes and work in progress, and

(5) had a depreciated original cost as of December 30, 1952 in excess of the assigned purchase price, i.e., $4,905,712.37, which amount the Commission ordered carried in an acquisition adjustments account and amortized as an expense at the rate of $327,047 a year.

Thus Mr. Justice Currie of the Wisconsin Supreme Court noted:

> "In other words, the petitioner had purchased such plant assets at a purchase price of $4,905,712.37 less than the depreciated original cost of such assets as of the date of petitioner's purchase." (Ap. A. p. 2, R. p. 233)

In said Supplemental Accounting Order the Commission also specified the depreciation rates (R. pp. 207-208) based on the lives of depreciable assets used in computing the depreciation reserve requirement. These rates composited to 4% of original cost of the property as of December 30, 1952 (R. p. 138). The Commission then ordered:

> "3. That the depreciation expense of the original cost of said property shall be computed based on the application of the depreciation rates, shown in schedule 2 attached hereto and made a part hereof, to the balances in the several depreciable plant accounts.
>
> 4. That the credit amount included in plant acquisition adjustments shall be amortized over a peri-

od of 15 years by credits to an account entitled 'Amortization of Plant Acquisition Adjustments', and included in operating expenses immediately following depreciation expense.

5. That the accounting procedures prescribed herein shall be without prejudice with respect to the determination of rate base or depreciation expense allowable in a proceeding involving service fares." (R. p. 141)

The annual depreciation allowance so computed was as of December 30, 1952 approximately $1,197,000, and the annual amortization credit $327,047.

In the Spring of 1953 Appellant petitioned the Commission to increase the fares which it was authorized to charge because of a $1,023,000 increase in Appellant's annual wage expense effective April 1, 1953. After several hearings the Commission entered its Order of September 17, 1953 (set forth in Appendix B hereof) in which it fixed the fares Appellant might charge for its transportation service so as to produce operating revenues computed as follows:

"The total estimated annual cost of operation including return can now be summarized:

	Amount	*% of Total*
Operation and maintenance	$16,699,924	84.09
Depreciation	1,200,000	6.04
Amortization of acquisition adjustment	(327,047)	(1.65)
Operating taxes	909,820	4.58
Income taxes	608,374	3.06
Return	768,000	3.88
Total	$19,859,071	100.00%

() Denotes red figure.

Note: Includes estimated increase in expenses due to required increases in gross revenues." (Ap. "B" p. 15, R. p. 114)

But for the inclusion of the negative $327,047 "amortization of acquisition adjustment", the forecast of Appellant's return would have been $441,053 instead of $768,000, producing a 2.91% rate of return on the original cost of Appellant's plant assets. Appellant's annual debt service and preferred stock dividend requirements alone totalled $526,536. (R. p. 144)

As stated by Mr. Justice Currie of the Supreme Court of the State of Wisconsin:

> "It is conceded that the Commission has followed the same method in computing depreciation of plant assets in the proceedings resulting in the subsequent fare orders of May 13, 1954 and November 5, 1954 which it employed in the findings and opinion portion of its fare order of September 17, 1953, now before us for review." (Ap. A. p. 5; R. p. 235)

Ratio Decidendi of the Wisconsin Judgment

The basis for the judgment from which this appeal was taken was set forth by Mr. Justice Currie as follows:

> "The net effect of the Commission's handling of the subject of depreciation in its fare order of September 17, 1953, was to base the depreciation allowed as an operating expense upon the price petitioner paid for the plant assets rather than upon the original cost of such assets." (Ap. A, p. 3; R. p. 234)

Then, contrary to the record and without any finding by the Commission that the price paid for the plant assets, measures the capital being consumed by Appellant in rendering public service, the Wisconsin Supreme Court confirmed the Commission Order, saying:

> "From the standpoint of both logic and equity we can perceive no reason why fares, which, after allowing as an operating expense depreciation and amor-

tization charges sufficient to return to petitioner *all of its actual investment cost* of its plant assets over the remaining estimated life thereof, will provide a return of 7.35 per cent on petitioner's net investment cost of the property employed in business, are unreasonable. It is true that the former owner sold such plant assets to petitioner at a price of $4,905,712.37 less than the depreciated original cost thereof as determined by the commission, and that, under the commission's method of computing future allowable depreciation as an operating expense chargeable to earnings, such $4,905,712.37 of original cost to the former owner will never be recouped out of future earnings of the system. However, it is the former owner and not petitioner who has been prejudiced thereby, not by any action of the commission with respect to allowable depreciation, but by such former owner's voluntary act in selling at a price materially below depreciated original cost." (Italics those of Mr. Justice Currie) (Bold face supplied) (Ap. A. pp. 10-11; R. p. 240)

The Wisconsin Supreme Court ignored the Commission finding as to the remaining depreciated original cost, and held that, upon acquisition by a regulated company, of plant assets which are used and consumed in rendering public service, the Commission may lawfully confiscate for the benefit of the riding public without compensation the service value of those assets in excess of the purchase price paid for them.

The Question presented is Substantial

The Commission *limited* Appellant's fares so as to produce specified net operating revenues, after taxes and an allowance for depreciation, sufficient to recoup only the purchase price of plant assets, instead of an allowance to recoup the remaining capital or service value in *depreciable* assets which will be consumed in rendering the

public service. The Wisconsin Supreme Court conceded that with depreciation so computed, $4,905,712.37 of the depreciated original cost of Appellant's plant assets *when purchased* can not be recouped by Appellant from the fares fixed by said Commission Order, although said depreciable assets are used and will be consumed in rendering public service.

The basic error which effects the unconstitutional confiscation of Appellant's property becomes crystal clear upon noting the Commission's *unchallenged* determinations or findings in this proceeding, to-wit:

1. The amount of the return or *net* operating revenues which the Commission found Appellant entitled to earn from fares which it fixed, to-wit: $768,000-$770,000. (R. pp. 116, 192)

2. The amount of annual depreciation which the Commission determined measured the annual consumption of capital or service value over the remaining life of said depreciable assets. The Commission estimate for the twelve months ending June 30, 1954, was $1,200,000, as set forth (Ap. B, p. 16, R. p. 115) in the Commission's Order of September 17, 1953. The Commission finding for the twelve months ending July 31, 1954, was $1,164,563 as set forth (Ap. C, p. 20, R. p. 193) in the Commission's Order of November 4, 1954.

The issue presented to this Court is the constitutionality of fares fixed to provide an *apparent* return of $768,000-$770,000 (Ap. B, p. 17, R. p. 114, and Ap. C, p. 19, R. p. 192), when in fact, by reason of an arbitrary reduction in operating expenses the net operating revenues will be only $441,000-$443,000, and provide a rate of return of only 2.91% on the depreciated original cost of the Appellant's property employed in rendering its transportation service.

The substantial question on this appeal is the lawfulness of the arbitrary reduction of the annual depreciation allowance effected by treating as an operating expense the *negative* $327,047 annual write-off of the acquisition adjustment credit. The Commission Order was based upon an accounting procedure which contravenes the due process requirements as determined by:

A. The ruling of this Court based on a stipulation of the Attorney General of the United States in *American Telephone & Telegraph Co. vs. United States,* 299 U. S. 232, and

B. The cost concept of an annual depreciation allowance which fares must constitutionally cover before computation of the return or net operating revenues.

ARGUMENT

A. The Commission Order fixes fares on the basis of an arbitrary write-off of plant property concededly having service value, which violates the Fourteenth Amendment.

In *American Telephone & Telegraph Co. v. United States,* 299 U.S. 232, this Court approved an order of the Federal Communications Commission imposing the uniform system of accounts upon that telephone utility. This court at pages 237-238 noted the definition of "original cost" and the basis for an entry in the "acquisition adjustment account" as follows:

> "The term 'original cost' as appearing in these rules receives, under Instruction 3 (S. 1), a special definition. '"Original cost" or "cost", as applied to telephone plant, franchises, patent rights, and right-

> of-way, means the actual money cost of (or the current money value of any consideration other than money exchanged for) property at the time when it was first dedicated to the public use, whether by the accounting company or by a predecessor public utility.' If actual costs are unknown, estimates are to take their place. Instruction 21 (B). From all this it follows that the sum of the three accounts which represent the original cost of property acquired by the accounting company from other telephone utilities, may be less or greater than the investment in such property by the accounting company itself. The difference is taken care of by account 100.4, Telephone Plant Acquisition Adjustment. The same rule provides in a subdivision designated (C) that 'the amount recorded in this account (i.e. 100.4) with respect to each property acquisition shall be disposed of, written off, or provision shall be made for the amortization thereof in such manner as this Commission may direct.' "

It was contended by the telephone utility that the rules authorized a write-off of the acquisition adjustment in violation of the Fourteenth Amendment. This Court negatived this contention with the following statement at page 240:

> "The Commission is not under a duty to write off the whole or any part of the balance in 100.4, if the difference between original and present cost is a true increment of value. On the contrary, only such amount will be written off as appears, upon an application for appropriate directions to be a fictitious or paper increment."

However, before so ruling, the Court requested the United States Assistant Attorney General to reduce to writing certain statements made in oral argument in re-

spect to the issue. The essence of this stipulation appears in the opinion as follows:

> "To avoid the chance of misunderstanding and to give adequate assurance to the companies as to the practice to be followed, we requested the Assistant Attorney-General to reduce his statements in that regard to writing in behalf of the Commission. He did this and informs us that 'the Federal Communications Commission construes the provisions of Telephone Division Order No. 7-C, issued June 19, 1935, pertaining to account 100.4' as meaning 'that amounts included in account 100.4 that are deemed, after a fair consideration of all the circumstances, to represent an investment which the accounting company has made in assets of continuing value will be retained in that account until such assets cease to exist or are retired; and, in accordance with paragraph (C) of account 100.4, provision will be made for their amortization.'
>
> We accept this declaration as an administrative construction binding upon the Commission in its future dealings with the companies."

In the instant case the Wisconsin Commission ordered the write-off over 15 years, of the acquisition adjustment credit, i.e., the *excess* of the depreciated original cost of the plant assets, when acquired, *as determined by the Commission,* over the price paid for the transfer to Appellant of title to said plant assets. Moreover, in this proceeding for fixing fares the Commission treated this annual $327,047 write-off as an operating expense, which, because it is a negative figure, thereby arbitrarily reduced the Appellant's operating expenses employed to compute net operating revenues. That this was an arbitrary write-off, such as was proscribed by this Court in *Amercian Telephone & Telegraph Co. v. United States,* 299 U. S. 232, is established of record herein by the following undisputed facts:

(a) The Chief of the Commission's "Accounts and Finance Department" specifically testified (R. p. 169) that if the Appellant *had paid the depreciated original cost* for said plant assets, i.e. $13,872,028.26, there would then have been no acquisition adjustment required on the books of Appellant, either black or red. In other words, had the Appellant paid $13,872,028.26 for said assets, Appellant would have been entitled to annual depreciation to recoup the entire remaining service value of depreciable assets without reduction by reason of any write-off. This establishes that said depreciated original cost did not represent any fictitious value subject to write-off *as an expense.*

(b) Appellant paid only $10,000,000 for a transportation system whose plant assets had a depreciated original cost of $18,174,759 on seller's books. (R. p. 127) Therefore the seller insisted (R. p. 179) on selling assets rather than the stock of the corporation which owned said assets in order to realize the loss and obtain the consequent income tax benefit. The officer of the seller who handled the transaction testified (R. pp. 173-175) that the aggregate realization from Appellant and said tax benefit was $14,700,000.

That said $14,700,000, which the seller testified it realized from the sale to the Appellant of said Milwaukee transportation system, represents real value, is confirmed by Commission's findings. Thus the depreciated original cost of the plant assets as of the date of purchase was found to be $13,872,028.26, *exclusive* of materials, supplies, accounts receivable, prepaid taxes and work in progress, to which the Commission allocated $1,033,684.11, or a total of $14,905,712.37.

The only case other than the instant one, which deals with the lawfulness of treating an annual write-off of an acquisition adjustment as an operating expense is *Harrisburg Steel Corp. v. Pennsylvania Public Utility Commission and Pennsylvania Power & Light Co.*, 109 Atl. (2d) 719, which involved the purchase of utility properties for more than the depreciated original cost. The Pennsylvania Commission, contrary to an order of the Federal Power Commission directed to the same utility, ordered the annual amortization of the debit acquisition adjustment be included *as an operating expense in a rate case*. This, of course, had the effect of reducing the net operating revenues and thereby provided a basis for an increase in rates. The Pennsylvania Court reversed the Pennsylvania Commission and approved the treatment thereof by the Federal Power Commission, stating:

> "And both Commissions ordered that the amount be written off the books of the company by amortization over a 15-year period at the rate of $1,746,150 per year. There was a vital difference, however, in the two orders: The Federal Power Commission directed that the amount be written off by charges to 'Miscellaneous Amortization' as a *disposition of income;* the Pennsylvania Commission directed the amortization by charges as *operation expense.* * * * *Fundamentally, the error in this phase of the appeals, arises from the fact that the Company with the aid of the Commission has transformed an administrative procedure, which it was bound to observe, into substantive law (albeit foreign to the processes of rate making) imposing new burdens on the rate payers.*" (Italics supplied)

Later in its opinion the Pennsylvania Court concluded at page 724:

> "And if the excess payments are to be amortized the method adopted by the Federal Power Commission is the proper one; as an accounting measure the excess is logically chargeable to the stockholders against gross income and not to the rate payers as operating expense."

In the instant case, the testimony of Mr. A. R. Colbert and the Commission findings ineluctably establish that the depreciated original cost of Appellant's depreciable plant assets, though in excess of the price paid for the transfer of title thereto, represented service value remaining in said assets, not fictitious value.

The fact that depreciation would permit recoupment of service value for which Appellant paid no assigned consideration is of no moment in Wisconsin. The Commission has allowed depreciation on depreciable assets even though acquired with donated or contributed capital, although it has refused to allow a return on such capital or include it in the rate base. See the decision in *City of St. Francis v. Public Service Commission of Wisconsin,* filed May 3, 1955 and reported in 270 Wis. 91, at page 93, 70 N.W. (2d) 221, at page 223. The arbitrary reduction of Appellant's annual depreciation allowance to limit recoupment of service value in depreciable assets to the price paid for plant assets effected an unlawful confiscation of property to the extent said service value exceeded said price and presents a substantial question.

B. Consumption of capital or service value in depreciable assets, not price for transfer of title to plant assets, measures the cost of service to be covered by the annual depreciation allowance.

The Wisconsin Supreme Court noted (Ap. A, p. 9, R. p. 239) the concession by the Commission that—

> " * * * reasonable depreciation and amortization charges to cover the cost of the plant used in rendering public service is a proper operating expense allowable in the determination of reasonable fares."

However, the Wisconsin Supreme Court failed to appreciate the *constitutional* basis for computing depreciation and amortization charges.

Annual depreciation and amortization, recognition of which is constitutionally required, is a charge against earnings to reflect *an item of cost,* to-wit, a systematic and rational estimate of the annual consumption of the capital or service value remaining at any given time in depreciable assets. Such annual charges over the expected remaining service life of said assets, less salvage, if any, are allowed to recoup the capital annually consumed in rendering the service, because it is a cost of that service.

The Wisconsin Supreme Court in effect has adopted the doctrine of *United Railways & Electric Co. v. West,* 280 U. S. 234, which was specifically overruled in *Federal Power Commission v. Hope Natural Gas Co.,* 320 U. S. 591, at pages 606-607. In the *West* case this Court held present values must be the basis for depreciation. This holding was reversed in the *Hope* case which approved depreciation based on the original cost of the property when first devoted to public service.

The Wisconsin Supreme Court would substitute the purchase price in a *bona fide* sale, which normally is the

best evidence of present value, for the appraisal basis of the *West* case. However, the Wisconsin court was unwilling to apply its own rule without restriction when the purchase price exceeded what it referred to as prudent investment.

The Wisconsin Supreme Court, in those instances in which the purchase price exceeded the original depreciated cost, would allow *depreciation on appreciation* if the Commission considered the purchase prudent. This completely loses sight of the proper basis for depreciation, i.e. as a factor of cost in rendering the service. Depreciation on appreciated value of assets already devoted to public service is not constitutionally required. However, a refusal to allow depreciation to recoup service value used and consumed in public service, because the purchase price is less than the depreciated original cost, violates the Fourteenth Amendment, when fares fixed on this basis do not provide net operating revenues, after taxes and depreciation, sufficient to cover even the annual debt service and preferred stock dividend requirements.

Now it is manifest that, as in the instant case, upon transfer of title to depreciable assets which have for a period of time been devoted to public service, the annual depreciation charge for continuing said use of those same assets does not change because of the transfer of title. The buyer's annual depreciation charge must still be related to the capital or service value *remaining unconsumed* in said assets at the date of acquisition and its consumption over the *remaining service life of said assets.* This is exactly the basis on which the Commission in its Supplementary Accounting Order of May 19, 1953 required Appellant to compute its annual depreciation allowance. The

technical language of the Order which establishes this was as follows:

> "The depreciation expense of the original cost of said property shall be computed based on the application of the depreciation rates, shown on Schedule 2 attached hereto and made a part hereof, for the *balances* in the several depreciable plant accounts." (Italics supplied) (R. p. 141)

The Appellant's annual depreciation so computed was estimated for the twelve months ending June 30, 1954 in the Order of September 17, 1953 to be $1,200,000 (Ap. B, p. 16, R. p. 115) and in its Order of November 4, 1954 found, for the twelve months ending July 31, 1954, to have been $1,164,563. (Ap. C, p. 20, R. p. 193) Both the 1953 estimate and the 1954 finding were then in effect reduced by $327,047 in this proceeding to fix fares.

Manifestly the consideration received for the transfer of title to the assets, which might in fact be transferred by gift or inheritance, does not *ipso facto* establish the remaining service value. This is implicitly conceded by Mr. Justice Currie when he says in his opinion:

> " * * * if the Wisconsin commission is to be consistent with its action in the instant case, it would have to permit deduction of amortization charges to permit recoupment of a premium paid over and above depreciated original cost to acquire plant assets of a former operating owner, if it determined the purchase price did not transcend the rule of *'prudent investment'*." (Italics those of Mr. Justice Currie)

Because he had ignored the proper basis for the depreciation and amortization charges, and adopted the price paid by the buyer for the plant assets, Mr. Justice Currie felt impelled to adopt a "heads we win, tails Appellant loses" rule. Had he fully considered the situation aris-

ing when title to operating properties devoted to public service are transferred by gift or inheritance, the fallacy in tying depreciation or amortization of depreciable assets devoted to public service to the price paid for title to plant assets would have been obvious.

As was remarked by Mr. Justice Brandeis in his famous opinion in *State of Missouri ex rel. Southwestern Bell Telephone Co. v. Public Service Commission,* 262 U. S. 276, at page 290, 67 L. Ed. 981, at page 986:

> "The thing devoted by the investor to the public use is not specific property, tangible and intangible, but capital embarked in the enterprise. *Upon the capital so invested the Federal Constitution guarantees to the utility the opportunity to earn a fair return.* *** The owner is at liberty, *in the absence of controlling statutory provision,* to withdraw his property from the public service; and, if he does so, may obtain for it exchange value. Compare Brooks-Scanlon Co. v. Railroad Commission, 251 U.S. 396, 64 L. ed. 323, P. U. R. 1920C, 579, 40 Sup. Ct. Rep. 183; Erie R. Co. v. Public Utility Comrs., 254 U.S. 394, 411, 65 L. ed. 322, 334, P. U. R. 1921C, 143, 41 Sup. Ct. Rep. 169; Texas v. Eastern Texas R. Co., 258 U.S. 204, 66 L. ed. 566, 42 Sup. Ct. Rep. 281. *But so long as the specific items of property are employed by the utility, their exchange value is not of legal significance.*
>
> The investor agrees, by embarking capital in a utility, that its charges to the public shall be reasonable. *His company is the substitute for the State in the performance of the public service; thus becoming a public servant.* The compensation which the Constitution guarantees an opportunity to earn is the reasonable cost of conducting the business. *Cost includes not only operating expenses, but also capital charges.* Capital charges cover the allowance, by way of interest, for the use of the capital, whatever the nature of the security issued therefor; the allowance for risk incurred; and enough more to attract capital." (Italics supplied)

Decisions of this Court establish that the right to a return, i.e. net operating revenues, guaranteed by the Constitution, refers to net operating revenues after operating expenses, including taxes and depreciation and amortization sufficient to permit the recoupment of the capital remaining in, i.e. the service value of, depreciable assets consumed in rendering public service.

Mr. Chief Justice Hughes in *Los Angeles Gas & Electric Corp. v. Railroad Commission of California, et al,* 289 U. S. 287, at page 304, 77 L. Ed. 1180, at page 1192, pointed out that the illegality of the end result may well be caused by error in the method of its determination, as follows:

> "The legislative discretion implied in the rate making power necessarily extends to the entire legislative process, embracing the method used in reaching the legislative determination as well as that determination itself. * * * When the legislative method is disclosed, it may have a definite bearing upon the validity of the result reached, but the judicial function does not go beyond the decision of the constitutional question. That question is whether the rates as fixed are confiscatory."

This was summed up specifically as to an annual depreciation allowance by Mr. Justice Cardozo in *Columbus Gas & Fuel Co. v. Public Utilities Commission of Ohio, et al,* 292 U. S. 398, 78 L. Ed. 1327. The Ohio Supreme Court had based its judgment on the fact that the Ohio statute did not authorize an annual allowance for amortization for leaseholds, well structures and equipment used in connection with furnishing gas. In reversing the Supreme Court of Ohio, Mr. Justice Cardozo said at pages 404-405:

> "To withhold from a public utility the privilege of including a depletion allowance among its oper-

ating expenses, while confining it to a return of 6½% upon the value of its wasting assets, is to take its property away from it without due process of law, at least where the waste is inevitable and rapid. * * * *Plainly the state must either surrender the power to limit the return or else concede to the business a compensating privilege to preserve its capital intact.* * * * 'Before coming to the question of profit at all the company is entitled to earn a sufficient sum annually to provide not only for current repairs but for making good the depreciation and replacing the parts of the property when they come to the end of their life.' Knoxville v. Knoxville Water Co., 212 U. S. 1, 53 L. ed. 371, 29 S. Ct. 148, supra; Lindheimer v. Illinois Bell Teleph. Co., April 30, 1934, 292 U. S. 151, ante, 1182, 54 S. Ct. 658. *It is idle to argue that a company using up its capital in the operations of the year will have received the same return as one that at the end of the year has its capital intact and interest besides.*" (Italics supplied)

Mr. Chief Justice Hughes in *Lindheimer, et al v. Illinois Bell Telephone Co.,* 292 U. S. 151, stated the basis for depreciation succinctly at page 167 as follows:

> "Broadly speaking, depreciation is the loss, not restored by current maintenance, which is due to all the factors causing the ultimate retirement of the property. These factors embrace wear and tear, decay, inadequacy, and obsolescence. Annual depreciation is the loss which takes place in a year."

This basis for depreciation was confirmed by Mr. Chief Justice Stone in *Federal Power Commission, et al v. Natural Gas Pipeline Co., et al,* 315 U. S. 575, at page 594, as follows:

> "This was in conformity with the established business practice, in the case of unregulated as well as regulated businesses, to make such a depreciation or amortization allowance chargeable annually to earn-

ings *as an operating expense* in order to provide adequately *for annual consumption of capital* in the business. Lindheimer v. Illinois Tel. Co., supra." (Italics supplied)

The Commission's fallacious justification for its Order.

The Commission's determination of Appellant's annual depreciation allowance pursuant to the Commission's Supplemental Accounting Order of May 19, 1953, was consistent with the decisions of this Court. It is the reduction of operating expenses by including the negative $327,047 annual write-off of amortization adjustment which was arbitrary and effected a confiscation of Appellant's property without due process of law.

The Commission in its opinion on rehearing (R. pp. 119-120) attempted to justify its action as follows:

"Now, when depreciation expense is allowed at approximately 4 percent on the original cost of the property and the excess of original cost over actual cost to the present owner is amortized, the following result is attained:

Annual depreciation on original cost of properties	$1,196,916
Annual amortization of acquisition adjustment account, being amount by which original cost exceeds cost to present owner	(327,048)
Net operating charge being equal to depreciation of cost to present owner	$ 869,868

Depreciation on the cost of property to the present owner was upheld by the United States Supreme Court in the *Hope* case (51 PUR (NS) 193, 320 U. S. 591) when the court specifically overruled a

> contrary holding in the earlier case of *United R. & Electric Co. v. West* (280 U.S. 234). In the *Hope* case the court said of depreciation based on cost, 'No more is required.' In the Commission's opinion that succinct statement applies to the circumstances of the instant case."

The Commission's justification fails because the record in the *Hope* case does not support the Commission's construction of the language from the *Hope* decision which is quoted out of context. The depreciation issue before this Court in the *Hope* case was whether the Constitution required depreciation and amortization to be based on present value. This contention was rejected in favor of the basis employed by the Federal Power Commission, i.e., the original cost of the depreciable plant assets used and useful in rendering the public service. Thus *the record* in the *Hope* case discloses:

1. Properties purchased by Hope from other utilities as operating units or systems were also involved. "In such cases these records (of the seller) were analyzed and the original cost determined precisely as was done in the case of the (Hope) Company's books and records for property by the Company." Ex. 20, Vol. I, page 182.

2. The Federal Power Commission Exhibits 57 and 57A were entitled "Original Cost of Gas Plant as at December 31, 1938." and Charles W. Smith under whose general supervision said Exhibits were prepared, testified:

> "The staff was instructed to determine original costs in accordance with the system of accounts prescribed by the Commission for public utilities and licensees." Vol. I, p. 227.

Later the same witness testified:

> "Original cost, as applied to gas plants, means *the cost of such property to the person first devoting it to public service.*" (Italics supplied) Vol. I, p. 232.

3. Exhibit 61, prepared by the Federal Power Commission, Vol. III, p. 175, recites that " * * * this report on the annual and accrued depreciation and depletion, as related to the original cost of the gas plant of the company, is submitted."

4. The Federal Power Commission in its decision, which was affirmed by the United States Supreme Court, stated, 44 P.U.R. at page 19:

> "The purpose of depletion and depreciation accounting is to offset diminution in service value[20] of property being used in service, and to determine as accurately as possible another element of the cost of service for a particular period * * * The cost of the property consumed annually in rendering that service should be charged to operating expenses to reflect the depletion and depreciation incurred."
>
> [20] " 'Service value' is the difference between original cost and the net salvage value of gas plant. Depletion and depreciation signify the consumption of service life of property and when that is translated into dollars it shows the loss in service value."

Although the Wisconsin Commission determined the annual depreciation previously taken by the seller was inadequate by over $4,300,000, it found that the remaining service value of the transportation system *when purchased* by Appellant exceeded the $10,000,000 paid by Appellant by $4,905,712.37. The $4,300,000 windfall which the riding public thus received because the seller took inadequate depreciation *prior* to the sale is no precedent for confiscation of Appellant's property by *ordering* inadequate annual depreciation after the sale. Thus in *Federal Power Commission v. Hope Natural Gas Co.*, 320 U. S. 591, this Court approved an order of the Federal Power Commission, which authorized depreciation on the basis of the original cost of properties when first

devoted to public service, although, as noted at page 597, the Federal Commission found Hope had previously "'actually accumulated an excessive reserve'[4] of about $46,000,000". The Federal Commission order permitted depreciation to recoup a service value which reflected accrued depletion and depreciation of only $22,328,016[(a)]. In other words, proper depreciation for the future based on original cost or service value was allowed even though it would duplicate to a substantial extent a depreciation reserve already collected from the gas consumers.

(a) "* * * It found that Hope during the years when its business was not under regulation did not observe 'sound depreciation and depletion practices' but 'actually accumulated an excessive reserve'[4] of about $46,000,000. Id. 44 PUR (NS) p. 18. One member of the Commission thought that the entire amount of the reserve should be deducted from 'actual legitimate cost' in determining the rate base.[5] The majority of the Commission concluded, however, that where, as here, a business is brought under regulation for the first time and where incorrect depreciation and depletion practices have prevailed, the deduction of the reserve requirement (actual existing depreciation and depletion) rather than the excessive reserve should be made so as to lay 'a sound basis for future regulation and control of rates.' Id. p. 18. As we have pointed out, it determined accrued depletion and depreciation to be $22,328,016; * * *." (320 U. S. at p. 597)

"[5]That contention was based on the fact that 'every single dollar in the depreciation and depletion reserves' was taken 'from gross operating revenues whose only source was the amounts charged customers in the past for natural gas. It is, therefore, a fact that the depreciation and depletion reserves have been contributed by the customers and do not represent any investment by Hope.' Id. p. 40. And see Railroad Commission v. Cumberland Teleph. & Teleg. Co. 212 US 414, 424, 425, 53 L ed 577, 582, 583, 29 S Ct 357. 2 Bonbright, Valuation of Property (1937), p. 1139."

Subordinate errors in the Wisconsin Supreme Court's justification for the Commission Order.

The Wisconsin Court sought to justify its confirmation of the Commission Order by distinguishing this case from *Harrisburg Steel Corp. v. Pennsylvania Public Utility Commission,* 109 Atl. (2d) 719, and *Cities Service Gas Co. v. Federal Power Commission,* 155 Fed. (2d) 694. A Pennsylvania statute required the utility in the first case to show on its books the original cost of plant assets "when first devoted to public service, and the reserve accumulated to provide for the depreciation thereof." The Wisconsin court erroneously assumed a statute requiring that records be so kept is distinguishable from an order of the Public Service Commission pursuant to a state statute. This basis for distinguishing the *Harrisburg* case is without any merit.

In the *Cities Service* case the order confirmed depreciation on the basis of original cost, although the accounting utility had acquired the physical assets for less than one-tenth of their original cost[(b)]. The Wisconsin Court held the Cities Service case distinguishable because (a)

(b) IN THE MATTER OF CITIES SERVICE GAS COMPANY — Federal Power Commission Reports, Volume 3, Page 459 at Pages 470 and 471, it is stated:

"*Deficit capitalized by Kansas Natural Gas Company.* — On November 30, 1926, when Cities Service Gas Company acquired the physical properties of Kansas Natural Gas Company, an affiliate, it included in plant account the deficit of that company amounting to $3,367,000, which had been capitalized on January 1, 1921. This peculiar accounting appears to have been the result of an effort to reflect on the books some approximation of the original cost of the property acquired by Kansas Natural Gas Company from its affiliate, The Kansas City Pipe Line Company. The Commission's staff, from an examination and analysis of the books and records of The Kansas City Pipe Line Company, found the original cost of the properties involved to be $3,893,031, and recommended that this sum be included, as of Novem-

the transfer of title was between affiliates, and (b) this issue was not contested in the Court. The fact that the seller was an affiliate would be of importance only if the sale or the sales price was questioned. This question was not in issue here because the purchase price was admittedly far under the depreciated original cost. Likewise, the failure to contest the Commission finding in court assumes that the Federal Power Commission may have made an error in its ruling and that the court in affirming that ruling made an error. Considering the array of interests represented by counsel in the Cities Service case, it can be assumed that the case was fully litigated.

Mr. Justice Currie in his opinion incorrectly stated that Appellant contended the annual depreciation allowance should be sufficient to permit replacement of equipment. Appellant did not and does not seek a reserve sufficient to pay the price of new equipment to replace the old, which, in a period of inflation, would dollarwise be greater than the original cost or service value of the assets replaced. Appellant in fact claimed in its Wisconsin brief that due process required only an annual allowance sufficient to recoup, over their remaining service life, the unconsumed capital or remaining service value of the depreciable assets, less salvage, if any.

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ber 30, 1926, in lieu of amount recorded on the books of Cities Service Gas Company for this property.[21] The Company has raised no objection to this liberal and obviously necessary adjustment. It is approved."

"[21]The plant account of Cities Service Gas Company at November 30, 1926, carried this property at $3,747,512, consisting of the $3,367,000 deficit and $380,512 paid for the common stock of The Kansas City Pipeline Company. The sum of $3,747,512 is before the write-up, as of November 30, 1926, hereinbefore discussed."

Mr. Justice Currie implies that "prudent investment" is something different from Appellant's original cost. Theoretically, original cost can be imprudent, but in the instant case the acquisition and employment of Appellant's plant assets have been subject to public regulation for more than thirty years. The original cost in the instant case was described by the Commission (R. p. 109) "as representing substantially the fixed cost of construction or acquisition." Furthermore, this record establishes (R. pp. 220-223) that said original cost is based upon a Commission appraisal made in 1914 to which has been added the cost of additions and from which has been subtracted the cost of subsequent retirements.

In the case of *Waukesha Gas & Electric Co. v. Railroad Commission,* 181 Wis. 281, upon which the Wisconsin Supreme Court relied, it was expressly stated at page 301:

> "However, the question of whether or not the investment was prudent must be determined as of the the time when it was made. It may not be possible to avoid adverse conditions and the utility may be entitled to justify charges which at the time the matter is under investigation seem large."

Mr. Justice Brandeis in a note at page 289 of his opinion in *State of Missouri ex rel. Southwestern Bell Telephone Co. v. Public Service Commission,* 262 U. S. 276, 67 L. Ed. 981, adverted specifically to the meaning of "prudent investment" when designating an amount invested in public utility assets, stating:

> "The term prudent investment is not used in a critical sense. There should not be excluded from the finding of the base, investments which, under ordinary circumstances, would be deemed reasonable. The term is applied for the purpose of excluding what might be found to be dishonest or obviously

> wasteful or imprudent expenditures. Every investment may be assumed to have been made in the exercise of reasonable judgment, unless the contrary is shown."

Mr. Justice Douglas concisely noted at page 601 of the *Hope* case:

> "The heart of the matter is that rates cannot be made to depend upon 'fair value' when the value of the going enterprise depends on earnings under whatever rates may be anticipated."

Neither can depreciation be made to depend upon the purchase price because the price paid depends, not upon cost of the plant, but upon a value determined by earnings under whatever rates may be anticipated.

Thus the Wisconsin Commission formally noted (R. p. 127) that lack of earnings from existing rates and obsolescense was responsible in part at least for the sale of the Milwaukee transportation system at less than its depreciated original cost. Manifestly a purchase price bears no necessary relation to the service value remaining in depreciable plant assets, and in the absence of an express finding, constitutionally can not be assumed to measure it, on a record which will not support the assumption.

This proposition was developed as a truism in the 1935 congressional hearings of the 74th Congress on H.R. 5423, which ultimately became the Federal Power Act.[c]

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[c] Thus on page 2246 appears the following interrogation by Representative Pettingill of Commissioner Splawn:

> "Mr. Pettingill: Doctor, am I right in drawing the general conclusion that the difference between the rule laid down in *Smythe v. Ames* and the rule laid down in the bill comes down to this,

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that under the fair value basis, if price levels rise the utility can charge more, and if price levels or costs of materials, equipment, real estate and so forth, go down, they must charge less, whereas under the prudent investment theory, as Justice Brandeis said in the Southwestern case

It is not the value of the property that is dedicated to the public use; it is the money actually put in and once put in prudently, then you have got a level basis that will yield the same return regardless of rising and falling prices.

Am I right?

"Commissioner Splawn: I think you have made a distinction there that most students of the law would agree to, most students of this theory of valuation."

Earlier at page 417 the interrogation of Representative Pettingill in questioning Commissioner Seavey, one of the two co-authors of the Act, developed the following:

"Mr. Pettingill: Suppose a property was acquired at a bankrupt sale or at a time of very greatly depressed prices. That would be a legitimate cost. Would that be a prudent cost?

"Commissioner Seavey: No.

"Mr. Pettingill: How would you handle a situation like that? Does the buyer get any advantage as a result of his foresight, get any advantage of his bargain, or not?

"Commissioner Seavey: Well, do you want me to illustrate that?

"Mr. Pettingill: Yes, please.

"Commissioner Seavey: Under the practice of the California commission — I do not like to be referring to that commission all of the time, but that is where I have been — under the practice of the California commission, if a utility property is bought at a price that is much below the reasonable historical cost, the commission permits that property to be written upon the books of the company at the original cost — at the reasonable historical cost."

CONCLUSION

That this Court should review the decision of the Wisconsin Supreme Court is ineluctable since:

1) Jurisdiction exists pursuant to Title 28 United States Code, subparagraph (2) of Section 1257; and

2) The question presented is substantial since

(a) the Appellant's property is being confiscated by the State of Wisconsin for public use without compensation at the rate of $327,047 per year, and

(b) every Wisconsin public utility, under the decision from which this appeal is taken, if it acquires an operating property at a price less than its depreciable original cost, can have property thus advantageously acquired, confiscated for the benefit of the public without compensation.

This Court should note probable jurisdiction, direct that briefs on the merits be filed and that the cause be scheduled for oral argument.

Respectfully submitted,

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APPENDICES

APPENDIX A

Record pages 231-243

STATE OF WISCONSIN : IN SUPREME COURT

August Term, 1954

No. 134

MILWAUKEE & SUBURBAN TRANSPORT CORPORATION, a Wis. public service corporation,

Appellant,

v.

PUBLIC SERVICE COMMISSION,

Respondent,

CITY OF MILWAUKEE, et al.,

Intervenors.

APPEAL from an order of the circuit court for Dane County: ALVIN C. REIS, Circuit Judge. *Order vacated and cause remanded.*

Petition by the plaintiff Milwaukee & Suburban Transport Corporation (hereinafter referred to as the "petitioner") against the Public Service Commission of Wisconsin (hereinafter referred to as the "commission"), city of Milwaukee, and Milwaukee Board of School Directors, instituted pursuant to the Wisconsin Uniform Administrative Procedure Act (ch. 227, Stats.) to review an order dated September 17, 1953, of said commission fixing the transportation fares that petitioner might charge.

The commission moved the circuit court that the review proceedings be dismissed on the grounds that the issues therein had become moot by reason of a subsequent interim order entered (Record page 232) by the commission fixing new higher fares to be charged by the petitioner, which new fares had been put into effect. Such motion was granted and under date of June 2, 1954 the circuit court entered an order dismissing the review proceedings. From such order the petitioner has appealed to this court. The facts will be stated in the opinion.

(Record page 233) CURRIE, J. On December 30, 1952, petitioner purchased the tangible assets comprising the Milwaukee metropolitan local passenger transportation system from the then owner, The Milwaukee Electric Railway and Transport Company, for $10,000,000. Under date of December 15, 1952, the commission had issued a certificate of authority authorizing such purchase, and retained jurisdiction with respect to the accounting entries to be placed on petitioner's books to record the acquisition of such assets. The commission subsequently apportioned $8,966,315.89 of the purchase price to "plant accounts", the remaining $1,033,684.11 representing the acquired materials and supplies, accounts receivable, prepaid taxes, and work in progress. The commission also determined that the depreciated original cost of the plant assets which petitioner had purchased for $8,966,315.89 as of December 30, 1952, was $13,872,028.26. In other words, the petitioner had purchased such plant assets at a purchase price of $4,905,712.37 less than the depreciated original cost of such assets as of the date of petitioner's purchase.

Petitioner, on May 1, 1953, made application to the commission for authority to put certain proposed new

fares, representing an increase over then existing fares, into effect. Several hearings were held on such application and on September 17, 1953 the commission entered an order granting an increase of ten cents in the weekly pass fares, which was less than petitioner had requested, and denied any increase in the cash fares. The findings incorporated in such order set forth a table of petitioner's estimated annual cost of operation, as determined by the commission. Such table showed an annual depreciation figure of $1,200,000 with an adjusting red figure of $327,047 labeled "amortization of acquisition adjustment." The insertion of such adjusting red figure in effect reduced the amount of annual (Record page 234) depreciation expense, allowed as a component part of the total annual operating expense, from $1,200,000 to $872,-953. The $1,200,000 depreciation figure was based upon the original cost of the plant assets, while the $327,047 adjusting figure represented the sum of $4,905,712.37 (being the difference between the depreciated original cost of the plant assets and the price actually paid for the same by petitioner) amortized over the remaining estimated life of such plant assets of fifteen years.

The net effect of the commission's handling of the subject of depreciation in its fare order of September 17, 1953 was to base the depreciation allowed as an operating expense upon the price petitioner paid for the plant assets rather than upon the original cost of such assets. It is this act of the commission which petitioner challenges on this appeal, and its materiality will become apparent as we proceed.

On the basis of the annual income of petitioner under the fares permitted to be charged under said fare order of September 17, 1953, as estimated by the commission

in its findings and opinion comprising part of such order, the rate of return to petitioner, based upon *original depreciated cost* of the plant assets plus the amount invested in materials and supplies, working funds, and prepayments, would be 2.91 per cent. On the other hand, the commission found in its fare order of September 17, 1953 that the estimated annual revenues under the fares authorized by such order would produce an annual return to petitioner of 7.35 per cent on the net purchase price paid by petitioner for the plant assets, less depreciation and plus the amount invested in materials and supplies, working funds, and prepayments.

Petitioner timely filed its application for rehearing which the commission denied by order dated October 16, 1953. Thereafter, petitioner instituted action in the Dane county circuit court for review of the original order of September 17, 1953. (Record page 235) While such review proceedings were pending, petitioner on February 18, 1954 applied to the commission for further fare increases, and supplemented the same by a petition for emergency relief. On May 13, 1954 the commission entered an interim fare order granting petitioner authority to increase fares, and such increase was put into effect on May 16, 1954. It was because of this that the circuit court entered its order dismissing the review proceedings on the ground that the issues raised therein had become moot. Subsequent to the circuit court's order of dismissal the commission on November 5, 1954 entered a further fare order making permanent the increases allowed by the interim order and granting other increases, which new fares have also been put into effect. While such last mentioned order is not a part of the record, we have taken judicial notice thereof pursuant to sec. 328.021, Stats.

With this factual background we will now proceed to consider the two issues confronting us on this appeal, *viz.:*

(1) Are the issues in the review proceedings rendered moot by reason of the subsequent fare order of May 13, 1954, and November 5, 1954, and the putting into effect of the new increased fares authorized thereby?

(2) If not rendered moot, does the commission's basing of depreciation upon the purchase price or investment cost to the new purchaser, instead of original cost, result in unreasonable fares, or a rate of return which is confiscatory thereby rendering the action of the commission unconstitutional?

It is conceded that the commission has followed the same method in computing depreciation of plant assets in the proceedings resulting in the subsequent fare orders of May 13, 1954, and November 5, 1954, which it employed in the findings and opinion portion of its fare order of September 17, 1953, now before us for review. Nevertheless, the commission contends, that as to (Record page 236) a rate or fare order made by it with respect to a public utility (using "public utility" in its broad sense to include transport systems), the only question for review under our Uniform Administrative Procedure Act (ch. 227, Stats.) is the reasonableness of the rates or fares fixed by the order and that the methods or computations employed in fixing such rates or fares is immaterial. In support of such contention, the commission cites our opinion in *Wisconsin-Minnesota Light & Power Co. v. Railroad Comm.* (1924), 183 Wis. 96, 99, 197 N.W. 359, wherein we stated:

> "The constitutional rights of a utility are not invaded by the pursuit of a wrong method of valuation. In the absence of a method prescribed by the statute

> the *Commission* may proceed as it pleases. It is not its method that is to be reviewed but the result reached by the *Commission*. The statute charges the *Commission* with the duty of ascertaining and declaring a reasonable rate. If that is done, the method by which the *Commission* arrives at the result is not subject to criticism."

However, *Wisconsin-Minnesota Light & Power Co. v. Railroad Co., supra,* was decided prior to the enactment of our Uniform Administrative Procedure Act, and we deem that such act may have broadened to some extent the scope of judicial review in Wisconsin of fare and rate orders of the Public Service Commission. Sec. 227.15 of such Act provides in part as follows:

> "Administrative decisions, which directly affect the legal rights, duties, or privileges of any person, whether affirmative or negative in form * * * shall be subject to judicial review as provided in this chapter."

Sec. 227.20, Stats., specifies the scope of judicial review and we quote the following provisions thereof as being of possible materiality on this appeal:

> "* * * The court may affirm the decision of the agency, or may reverse or modify it if the substantial rights of the appellant have been prejudiced as a result of the administrative findings, inferences, conclusions or decisions being:
>
> "(a) contrary to constitutional rights or privileges; or
>
> "(b) in excess of the statutory authority or jurisdiction of the agency, or affected by other error of law; * * *
>
> (Record page 237) "(e) arbitrary or capricious * * *"

The fares charged by petitioner in the operation of its buses are subject to regulation by the commission under ch. 194, Stats., while the authority of the commission over the fares charged passengers using petitioner's street cars and trackless trolleys is to be found in ch. 195, Stats., by reason of the provisions of sec. 193.01(1), Stats. It is conceded, however, that the applicable statutes impose the duty upon the commission to fix or approve fares which are *just and reasonable* irrespective to which of the three types of transportation service of the petitioner they may apply.

Petitioner contends that the commission's method of computing depreciation of plant assets on the basis of petitioner's investment cost (the purchase price paid by it to the former transport company owner) instead of upon original cost necessarily results in the fares fixed by the commission being unreasonable and confiscatory. As hereinbefore noted, such method is expressly set forth in the findings and opinion portion of the 1953 fare order before us for review, and concededly has also been employed in the 1954 fare orders which the commission claims has rendered the controversy moot. We consider the beforequoted portions of secs. 227.15 and 227.20(1) confer the right of judicial review over such method of computing depreciation in view of the contention advanced that the employment of such method necessarily results in unreasonable and confiscatory fares.

Such conclusion as to the scope of the authorized judicial review necessarily disposes of the issue that the controversy has been rendered moot by the subsequent 1954 fare orders. The issue over the method of computation of depreciation presents a continuing controversy, which was not ended by the September 17, 1953 fare order be-

ing superseded by the 1954 fare orders, and therefore the controversy presented in the present review proceedings is not moot.

In *Boise City Irr. & Land Co. v. Clark* (9th cir. 1904), (Record page 238) 131 Fed. 415, an order of the Board of Water Commissioners fixed for a period of one year the maximum rate to be charged by a water utility. The corporate utility appealed on grounds that the order was unconstitutional. The board contended the appeal should be dismissed as moot because one year had expired and the order was no longer effective. The federal court rejected this contention, stating (at pages 418-419):

> "It is contended on the part of the appellees that, as the period for which the rate in question was fixed has expired, the case has become but little, if any, more than a moot case; but the courts have entertained and decided such cases heretofore, partly because the rate, once fixed, continues in force until changed as provided by law, *and partly because of the necessity or propriety of deciding some question of law presented which might serve to guide the municipal body when again called upon to act in the matter.*" (Emphasis supplied)

This court had occasion in *Smith v. Smith* (1932), 209 Wis. 605, 245 N.W. 644, to consider the nature of a moot case and the opinion quotes definitions thereof from courts of other jurisdictions consistent with our holding herein. In that case an order was entered modifying a divorce decree so as to award custody of a child for a sixty day period to the maternal grandfather. It was contended on appeal that the case was moot because the sixty day period had expired. With respect to such contention this court stated (at p. 609):

> "There is every reason to believe that the defendant will again make a similar motion to modify

the judgment. Since the trial court has the right to modify its judgment relating to the custody of this child whenever the interest of the child demands it (sec. 247.24, Stats.), we think that while the particular order complained of is moot, the controversy over the custody of this child is not moot and should not be so considered, and that therefore the questions raised on this appeal should receive consideration to the end that if and when this controversy is revived it may be determined upon correct principles and upon proper procedure."

Having concluded that the controversy before us on this appeal is not moot, we now turn to consideration of the issue presented on the merits of whether the allowance by the commission of depreciation of the plant assets based on petitioner's investment cost, instead of the original cost to the former owner of (Record page 239) such assets, resulted in unreasonable or confiscatory fares.

Inasmuch as the commission's brief concedes that reasonable depreciation and amortization charges to cover the cost of the plant used in rendering public service is a proper operating expense allowable in the determination of reasonable fares, it is unnecessary to cite any of the numerous authorities so holding. From this conceded premise, and a quotation from Mr. Chief Justice Stone's opinion in *Federal Power Commission v. Natural Gas Pipeline Co.* (1942), 315 U.S. 575, 594, 62 Sup. Ct. 736, 86 L.Ed. 1037, that the depreciation or amortization expense chargeable annually to earnings as an operating expense is *"in order to provide adequately for annual consumption of capital in the business"*, petitioner advances the hypothesis that the *capital consumed* must be that invested in the plant assets *when first devoted to public service*. However, we do not consider that such

hypothesis urged by petitioner is necessarily the correct one when there has been a *bona fide* transfer and sale of the plant assets under circumstances whereby the purchaser has a different investment cost than the original owner.

Petitioner states that its plant assets will in time wear out and, if it is to continue in the transportation business its physical plant must eventually be replaced. Because of this it contends that the net depreciation allowance computed by the commission will be insufficient to permit such replacement, which would in itself prove the commission's method of computing depreciation erroneous. The refutation of this argument is to be found in the dissenting opinion of Mr. Justice Brandeis in *Pacific Gas & E. Co. v. City and County of San Francisco* (1924), 265 U.S. 403, 424, 44 Sup. Ct. Rep. 537, 68 L. Ed. 1075, wherein he stated:

> "Under the rule which fixes the rate base at the amount prudently invested, the inevitable errors incident to fixing the year's depreciation charge do not result in injustice (Record page 240) either to the utility or to the community. If, when plant must be replaced, the amount set aside for depreciation proves to have been inadequate, and investment of new capital is required, the utility is permitted to earn the annual cost of the new capital."

We are primarily here concerned with whether basing allowable depreciation on petitioner's actual investment cost results in unreasonable fares. If the resulting fares are determined to be reasonable, then there is no constitutional problem presented of confiscatory rates or fares, as pointed out by Mr. Chief Justice Stone in *Federal Power Commission v. Natural Gas Pipeline Co., supra.* (See 513 U.S. at p. 586.) From the standpoint of both

logic and equity we can perceive no good reason why fares, which, after allowing as an annual operating expense depreciation and amortization charges sufficient to return to petitioner *all of its actual investment cost* of its plant assets over the remaining estimated life thereof, will provide a return of 7.35 per cent on petitioner's net investment cost of the property employed in the business, are unreasonable. It is true that the former owner sold such plant assets to petitioner at a price of $4,905,712.37 less than the depreciated original cost thereof as determined by the commission, and that, under the commission's method of computing future allowable depreciation as an operating expense chargeable to earnings, such $4,905,712.37 of original cost to the former owner will never be recouped out of future earnings of the system. However, it is the former owner and not petitioner who has been prejudiced thereby, not by any action of the commission with respect to allowable depreciation, but by such former owner's voluntary act in selling at a price materially below depreciated original cost.

Petitioner relies upon the authority of *Harrisburg Steel Corp. v. Pennsylvania Public Utility Commission* (1954), 000 Pa. Super. 000, 109 Atl. (2d) 719; and *Cities Service Gas Co. v. Federal Power Commission* (10th Cir. 1946), 155 Fed. (2d) 694, affirming *In re Cities Service Gas Co.*, 3 F. P. C. 549, to (Record page 241) support its contention that depreciation must be based upon original cost and not the investment cost of the purchaser, where there has been a transfer as the result of a purchase and sale.

The *Harrisburg Steel Corp. Case* is readily distinguishable from the case at bar because grounded upon a Pennsylvania statute which gives the Pennsylvania regulatory commission power to require a public utility to establish

and keep as part of its accounts continuing property records, and may require accounts and records in such manner " * * * as to show, currently, the original cost of such property *when first devoted to the public service,* and the reserve accumulated to provide for the depreciation thereof." (Emphasis supplied)

In the *Cities Service Gas Co. Case* the federal circuit court of appeals for the tenth circuit in the majority opinion stated that the accrued depreciation of Cities Service had been "calculated as the sum of the annual depreciation expense *from the beginning of the property*". From additional facts stated in the opinion in the proceedings below before the Federal Power Commission (3 F. 459, at pages 470-471) it appears that Cities Service acquired properties of an affiliate original costing $3,893,031 for $380,512, and the commission's staff recommended that the original cost figure of $3,893,031 be used in arriving at original cost of Cities Service's properties for purposes of computing depreciation. As pointed out by the Federal Power Commission, Cities Service made no objection to this.

There are two material differences between the facts in the *Cities Service Gas Co. Case* and those of the instant case. In the first place, the sale in the former was between affiliated corporations, while in the case at bar we have a sale at arm's length between seller and purchaser. Secondly, no party to the proceedings in the *Cities Service Gas Co. Case* contended that the Federal Power Commission's act of basing depreciation on original cost, instead of Cities Service's investment cost, (Record page 242) resulted in unreasonable or confiscatory rates. We, therefore, do not consider the *Cities Service Gas Co. Case* to be a precedent that should control our decision in the instant case.

Petitioner's brief quotes a portion of the opinion of the Pennsylvania superior court in *Harrisburg Steel Corp. v. Pennsylvania Public Utility Commission, supra, in which it criticizes* as unfair to the rate payers the act of the Pennsylvania regulatory commission in approving for rate making purposes the deduction of amortization charges against income based upon the premium which the purchasing utility paid to the former owner over and above depreciated original cost. This is the exact antithesis of the fact situation in the instant case, but, if the Wisconsin commission is to be consistent with its action in the instant case, it would have to permit deduction of amortization charges to permit recoupment of a premium paid over and above depreciated original cost to acquire plant assets of a former operating owner, if it determined the purchase price did not transcend the rule of *"prudent investment"*. As pointed out in *Waukesha Gas & Electric Co. v. Railroad Comm.* (1923), 181 Wis. 281, 301, 194 N.W. 846, both the commission and this court are committed to the *"prudent investment"* theory in rate cases, and the application of this principle would afford protection to rate payers in case of a purchase by a utility of plant assets from a former operating owner at an excessive price.

The commission has a considerable latitude in matters of policy in regulating utilities and public transportation systems, because such questions of policy are generally the function of the commission and not the courts. Therefore, whatever accounting method the commission employs in computing allowable depreciation in a rate or fare case will not be disturbed upon judicial review unless it in itself results in producing rates or fares that are unjust or unreasonable.

(Record page 243) In conclusion, it is our considered judgment that the commission's method of computing allowable depreciation attacked in the instant case does not result in unreasonable or confiscatory fares.

By the Court. — Order vacated and cause remanded with directions to enter judgment confirming in all respects the fare order of the commission dated September 17, 1953.

APPENDIX B

(Record page 102-117) FINDINGS, OPINION AND ORDER OF THE PUBLIC SERVICE COMMISSION DATED SEPTEMBER 17, 1953

BEFORE THE PUBLIC SERVICE COMMISSION OF WISCONSIN

Application of Milwaukee and Suburban Transport Corporation for Authority to Increase Fares to Cover Increased Salaries and Wages	2-SR-2629 MC-1467

FINDINGS, OPINION, AND ORDER

* * *

(Record page 114) It is expected that the company will have about $7,000 of income from noncarrier operations. Deduction of this from total return requirements leaves $768,000 to be derived from transportation operations.

The total estimated annual cost of operation including return can now be summarized:

	Amount	*% of Total*
Operation and maintenance	$16,699,924	84.09
Depreciation	1,200,000	6.04
Amortization of acquisition adjustment	(327,047)	(1.65)
Operating taxes	909,820	4.58
Income taxes	608,374	3.06
Return	768,000	3.88
Total	$19,859,071	100.00%

( ) Denotes red figure.

Note: Includes estimated increase in expenses due to required increases in gross revenues.

* * *

(Record page 115) It is of interest to note that the return component comprises but a small component, 3.88 percent of the total costs of operation, and of this return the common stock earnings allowance (the noncontractual portion of the return) is about 1.2 percent of total operating costs.

Comparison of the total annual costs of operation (including return) shown above at $19,859,000 with revenues at present fares of $19,502,000 indicates an additional revenue requirement of $357,000. It is estimated that an increase of 10 cents in the price of all weekly passes will produce this additional revenue, and the order herein will so provide.

Findings

THE COMMISSION FINDS:

1. That the total cost (including return) of furnishing transportation service in the Milwaukee metropolitan area for the 12 months ending June 30, 1954, will be as follows:

Operation and maintenance expenses	$16,699,924
Depreciation	1,200,000
Amortization of acquisition adjustment	(327,047)
Operating taxes	909,820
Income taxes	608,374
Return	768,000
Total cost, including return	$19,859,071

( ) Denotes red figure.

2. That the amount required to cover bond interest, note interest, amortization of debt (Record page 116) expense, preferred dividends, and a reasonable earning on common stock, for the 12 months ending June 30, 1954, is $775,000, of which $7,000 will be derived from non-

carrier operations and $768,000 will be required from transportation operations.

3. That $768,000 is equal to 7.35 percent of the net investment cost of the property less depreciation reserve and plus materials and supplies, working funds and prepayments of $10,448,639, to 5.06 percent of the same base figure with property stated at net original cost of $15,189,948 and to 7.31 percent of par value of outstanding securities of $10,500,000.

4. That $768,000 is a reasonable return to be earned from transportation operations.

5. That the present fare structure is inadequate in that it does not produce revenues sufficient to cover total costs of operation including return.

6. The present fare structure, adjusted to reflect a 10-cent increase in the price of all weekly passes including student passes, will produce current annual passenger revenues of $19,656,000, and the total annual operating revenues will be as follows:

Passenger revenues	$19,656,000
Other operating revenues	203,025
Total	$19,859,025

7. That the ratio of operating expenses (excluding income taxes) shown in Finding 1 to (Record page 117) the operating revenues shown in Finding 6 is 93.07 percent, which is reasonable.

8. That the fares provided in Finding 6 above are reasonable and lawful.

Conclusions of Law

THE COMMISSION CONCLUDES:

That it has jurisdiction under sections 194.19, 194.22 and 195.05 to enter an order authorizing the fare structure specified in the foregoing findings of fact.

Order

IT IS THEREFORE ORDERED:

1. That the Milwaukee & Suburban Transport Corporation be and hereby is authorized to increase the price of all weekly passes, including student passes, by 10 cents.

2. That this order become effective 20 days from the date of issuance and that the necessary tariff changes may be filed thereafter on not less than 5 days' notice to the Commission and the public.

3. That the application in all other respects be denied.

Dated at Madison, Wisconsin, this 17th day of September, 1953.

By the Commission.

Edward T. Kaveny
Secretary

APPENDIX C

(Record page 186-192) BEFORE THE PUBLIC SERVICE COMMISSION OF WISCONSIN

Application of Milwaukee & Suburban Transport Corporation for Authority to increase Fares	2-SR-2740 MC-1496

Findings, Opinion, and Order

* * *

(Record page 192) In its order issued September 17, 1953 in dockets 2-SR-2629 and MC-1467 the Commission found that the amount required to cover bond interest, note interest, amortization of debt expense, preferred dividends, and a reasonable earning on common stock was $775,000 of which $768,000 was required from transportation operations. It is the opinion of the Commission that there has been no change in conditions which justifies a different finding of return requirement in this proceeding. Accordingly, there will be included in the total costs of rendering transportation service a return allowance of $770,000.

The Commission also found in the above-mentioned order that the amortization of the credit acquisition adjustment account in the annual amount of $327,048 was properly (Record page 193) includible in operating expenses so that the combination of depreciation on original cost of the property and the amortization of acquisition adjustment would reflect depreciation on the company's investment cost of the property. There is nothing in this record which justifies a change in the position taken at that time.

The order and all the testimony in dockets 2-SR-2629 and MC-1467 relating to the items discussed above were

incorporated into the record of this proceeding by stipulation.

The results of operations for the 12 months ended July 31, 1954 were as summarized in the following table:

Operating revenues	$18,734,574
Operating expenses (before incomes taxes)	
Operation and maintenance	16,208,402
Depreciation	1,164,563
Amortization of acquisition adjustment	(327,048)
Operating taxes	901,510
Total	$17,947,427
Net operating revenues before income taxes	$ 787,147
Operating ratio before income taxes	95.8%

* * *

APPENDIX D

STATUTES AND CONSTITUTIONAL PROVISIONS INVOLVED ON THIS APPEAL

Different statutory provisions govern the fixing of rates for each of Appellant's operations. Section 194.19 which applies to motor buses reads in part as follows:

> "All rates, fares and charges made by any common motor carrier of property or passengers shall be just and reasonable, * * * "

As to the trackless trolley and street car operations other statutory provisions are material. Section 193.01(1) reads in part:

> "Transportation systems employing overhead trolley structures for the propulsion of cars without tracks shall be deemed railroads subject to the provisions of chapter 195. * * * "

Section 195.02(1) reads in part:

> "In this chapter, unless a different meaning is manifest: 'Railroad' means and embraces * * * all street and interurban railway companies."

Section 195.08(1) reads.

> "Every railroad shall furnish reasonably adequate service and facilities, and the charges made for the transportation of passengers or property or for any service in connection therewith, or for the receiving, switching, delivering, storing or handling of property shall be reasonable and just, and every unjust and unreasonable charge for such service is prohibited and declared to be unlawful."

Section 195.05(1) reads:

> "Whenever the commission shall find any existing rate, fare, charge, or classification, or any joint rate,

or any regulation or practice affecting the transportation of persons or property, or any service in connection therewith is unreasonable or unjustly discriminatory or any service is inadequate it shall determine and by order fix a reasonable rate, fare, charge, classification, joint rate, regulation, practice or service to be imposed, observed and followed in the future, in lieu of that found to be unreasonable or unjustly discriminatory or inadequate."

* * *

Article I of the Wisconsin Constitution, Section 13:

"The property of no person shall be taken for public use without just compensation therefor."

Fourteenth Amendment of the United States Constitution, Section 1:

" * * * No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws."

INDEX TO APPENDICES

Page

Appendix A—Opinion and judgment of the Wisconsin Supreme Court appealed from 1-14

Appendix B—Material portion of the Findings, Opinion and Order of the Wisconsin Public Service Commission, dated September 17, 1953, confirmed by the Wisconsin Supreme Court 15-18

Appendix C—Material portions of the Findings, Opinion and Order of the Wisconsin Public Service Commission, dated November 4, 1954 19-20

Appendix D—Statutes and Constitutional Provisions involved on this Appeal 21-22

Section 194.19, Wisconsin Statutes 21

Section 193.01 (1), Wisconsin Statutes 21

Section 195.02 (1), Wisconsin Statutes 21

Section 195.05 (1), Wisconsin Statutes 21

Section 195.08 (1), Wisconsin Statutes 22

Article I, Section 13, Wisconsin Constitution 22

Fourteenth Amendment of the United States Constitution, Section 1 22